



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201211026**
Release Date: 3/16/2012
Date: December 19, 2011
UIL Code: 501.03-05
501.32-00
501.33-00

Contact Person:
Identification Number:
Contact Number:
Employer Identification Number:
Form Required To Be Filed:
Tax Years:

Dear

This is our final determination that you do not qualify for exemption from federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Since you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

Letter 4038(CG) (11-2005)
Catalog Number 47632S

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois Lerner
Director, Exempt Organizations

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: October 18, 2011

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:

B = individual

C = individual

D = individual

E = individual

F = business

H = business

p = dollar amount

q = dollar amount

r = dollar amount

s = dollar amount

t = dollar amount

W = state

X = date

Y = state

Z = state

UIL Nos:

501.03.05

501.32.00

501.33.00

Dear

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code ("Code") as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

Issues

Are you formed to obtain grants primarily benefitting B through F? Yes, for the reasons given below.

Will your activities serve substantial non-exempt purposes contrary to Section 501(c)(3) of the Code? Yes, for the reasons stated below.

Are private interests being served prohibiting you from qualification under Section 501(c)(3) of the Code? Yes, for the reasons stated below.

Do you fail to meet the operational and organizational test? Yes, for the reasons stated below.

Facts

B, the owner and one of the operators of F, was approached by H about opportunities to pursue grants. H is a professional grant writing company based in W.

F, a for profit, is described as a small family business based around home made cuisine. For over three years F has served homemade food to the public in the state of Z. F is open seven days a week ranging in time from 6:30am to 5:00pm. F's web site lists all dishes served at the restaurant with prices, as well as information on catering. F's customers typically consist of local workers and businesses in the surrounding community. F also accepts old stereo, audio or film equipment and supplies. F is managed/operated by B and her family, C and D.

An employee of H informed B that H would provide specialized services focused primarily on, but not limited to, the grant writing process in obtaining funding for F. As a result, B wired H t dollars in return for setting up a business plan and re-making F's web site. B was also told that she could get s dollars in funding for F.

The business plan provided to you includes a summary of F, business objectives of F, a general industry analysis and business strategies, which includes marketing. Among the marketing strategy it states, "We market through billboards, supporting local events like YMCA swim meets and police fund raisers as well as commercials."

Over the course of the next two months, B called H numerous times to inquire about the status of F's funds. B then received a call from an employee of H requesting r dollars to cover the cost of additional paper work. As a result, B wired r dollars to H and signed a contract for supplemental document services, which includes the preparation of documents for a grant application.

Soon after, an employee of H contacted B to help B set up a foundation to help local small businesses, like company F. The details and benefits of creating a foundation were explained to B. H requested q dollars to establish this foundation. B explained they did not have the money so an agreement was established to pay p dollars now and send H the rest of the money at a later date.

B signed a contract with H to prepare and supply the necessary paper work to establish a foundation and to help secure grants. H explained they would take a percentage of the grant for their work after the money had been received, but an exact figure or percentage was never established.

The contract stated H would perform the following:

- 1) File Articles of Incorporation in the state Y
- 2) Act as your Resident Agent for one year
- 3) Provide bylaws
- 4) Provide sample minutes
- 5) Provide corporate seal
- 6) File a corporate Employer Identification number (EIN)
- 7) File the Form 1023
- 8) Provide a non-profit CD
- 9) Provide consulting and guidance

Another employee of H submitted documents to B enabling your creation. Soon after, Form 1023 was filed, requesting exemption.

Under the guidance of H, you were incorporated in state Y on X, two months after submitting your application for exemption. Your Articles of Incorporation state you are a nonprofit public benefit entity and are not organized for the private gain of any person. You have stated H instigated your creation, creating every part including your name, however, H is serving "only as an investor" to you.

Your Articles of Incorporation list H as your registered agent and E, an individual affiliated with H, as your incorporator. B is listed as your initial director and trustee. Although you were incorporated in Y, you will conduct your activities primarily in Z.

B (President and Treasurer), C (Secretary) and D (Director) are listed as your governing members, and are of the same family.

Your past and present activities have been exhibited through F, a small family business owned by B, that serves homemade cuisines. You indicated the ability for people to pay for their daily meals has been significantly reduced. You wish to expand the availability to serve homemade meals prepared by F to those without the economic ability to pay.

You want to provide meals through a number of sources. One method would be through the use of vouchers. Families would be able to exchange meal vouchers at F on any business day to receive their free meals. The voucher would aid F in specifically targeting those in need. You will minimize abuse by requiring a bi-monthly registration. Vouchers would be given to those without the economic ability to obtain F's meals but you did not detail the criteria for who would qualify to receive vouchers. When asked for clarification on your voucher program, your response was "At no point in our responses did we state or propose the idea of redeemable food vouchers".

You will provide food and refreshments to local organizations such as police/fire departments and schools the same way it has been done in the past by F. Due to the receipt of grants, you will be able to provide these meals in greater frequency through F.

Certain days of the week (Monday, Wednesday and Saturday) will be set aside for targeted groups to receive free meals. There would be a regular schedule for delivery to these groups, and the meals provided to local organizations would then be distributed to their residents.

You will hire local residents to help with food production and distributions. You indicated that through your hiring plan you will be bettering the community. Subsequently, you stated that F, after receiving a grant from H, would be the entity hiring the additional employees.

Annual events such as local school gatherings, meetings, or sporting events would be supplied refreshments and meals while also acting as an exhibit letting the local townspeople know of the services provided by F through you. Families would then be able to apply for meal vouchers directly at the events.

You will conduct your activities at the same location as F. Documents submitted with your application outline plans for funds that will be received for F, including implementing capital improvements to the location where F operates, buying new equipment, inventory and supplies. You also submitted detailed budgets for the operations of F for advertising, labor, rent, utilities, legal and accounting, supplies, insurance and general. Out of the \$ dollars you projected on your budgets you have listed only fundraising expenses making up only 5% of your total revenue. No other expenses are given to validate your statement that you will focus on charitable funding to support small businesses.

You have indicated two separate grants have been promised, both in the amount of \$ dollars. A request for supplemental documents submitted to H is an application for a grant under which you have outlined the purpose of your business and mission statement – describing the operations of F. B, as client, and F, in name, are both listed on this document.

After submitting your application for exemption B received a call from an unidentified representative of H indicating funding for both you and company F were ready. No documentation was provided demonstrating the availability of these funds or that any funds had been received or secured by H.

Law:

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax of corporations organized and operated exclusively for charitable, scientific, or educational purposes, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(2) of the Income Tax Regulations provides an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides an organization is not organized and operated exclusively for one or more exempt purposes unless it serves public rather than private interests. Thus, to meet the requirement it is necessary for an organization to establish that it is not organized and operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 179 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

In P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196 (1984), an organization operated bingo at a bar (a for-profit enterprise) for purposes of raising money for scholarships. The board of directors included the bar's owners and accountant, and two other persons. The court reasoned that, because the bar owners controlled the organization and appointed its directors, the organization's fundraising activities could be used to the advantage of the bar owners, and thus, provide them with a maximum private benefit. The organization claimed that it was independent because there was a separate accounting and that no payments were going to the bar. The court maintained that the organization's and the bar's activities were so interrelated as to be "functionally inseparable." A separate accounting did not change that fact. Thus, the organization did not operate exclusively for

exempt purposes, but rather benefited private interests – the bar owners. Exemption was properly denied.

In National Association of American Churches v. Commissioner, 82 T.C. 18 (1984), the court denied a petition for declaratory judgment that the organization qualified for exempt status as a church. In addition to evidence of a pattern of tax-avoidance in its operations, the court noted that the organization had failed to respond completely and candidly to IRS during administrative processing of its application for exemption. An organization may not declare what information or questions are relevant in a determination process. It cited a number of declaratory relief actions that upheld adverse rulings by the Service because of the failure of the applicants to provide full and complete information on which the Service could make an informed decision.

Church by Mail, Inc. v. Commissioner, T.C. Memo 1984-349, aff'd 765 F. 2d 1387 (9th Cir. 1985) Church by Mail sent out sermons in numerous mailings which required a great deal of printing services. A for-profit company, controlled by the same ministers, provided the printing and the mailing. The services were provided under two contracts. The contracts were signed by the two ministers for both the organization and the for-profit company. The organization's business comprised two-thirds of the overall business done by the for-profit company. The court determined that there was ample evidence in the record to support the finding that the organization was operated for the substantial non-exempt purpose of providing a market for the services of the for-profit company. The Court of Appeals pointed out that "the critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church." Moreover, the ministers' dual control of both the Church and the for-profit company enables them to profit from the affiliation of the two entities through increased compensation.

In International Postgraduate Medical Foundation v. Commissioner, TCM 1989-36, the Tax Court concluded that when a for-profit organization benefits substantially from the manner in which the activities of a related nonprofit organization were carried on, the latter organization was not operated exclusively for exempt purposes within the meaning of section 501(c)(3), even if it furthers other exempt purposes.

In KJ's Fund Raisers, Inc. v. Commissioner, 74 T.C.M. 669 (1997), the court held that a nonprofit organization, which sold lottery tickets on the premises of a for-profit business had a substantial non-exempt purpose to enhance the profits of the for-profit business. The owners of the for-profit business formed the nonprofit organization purportedly to raise funds for distribution to charitable causes. The nonprofit's lottery tickets were sold during the regular business hours by the owners and employees of the for-profit business. The owners of the for-profit initially controlled the board and later indicated that it would vest control in unrelated parties. The nonprofit opined that the organization "would fold without the original founders of the organization as officers." In finding that the nonprofit had a

substantial nonexempt purpose, the court reasoned that the owners of the for-profit were in a position to control the nonprofit. Additionally, the court found that the publicity received by the for-profit was a significant benefit.

Application of Law:

You are not described in section 501(c)(3) of the Code as you are not organized and operated for exclusively charitable, educational, or religious purposes. Specifically, your Articles do not contain a valid purpose or dissolution clause and your operations serve private interests.

You do not meet Section 1.501(c)(3)-1(a)(1) of the Regulations as you are not organized and operated exclusively for one more exempt purposes. The purpose clause contained in your organizing document is too broad and does not limit your purpose or activities to those that are exclusive under 501(c)(3). Further, your organizing document does not contain a dissolution clause. For these two reasons you fail the organizational test.

Your income will inure to insiders and your operations will result in impermissible private benefit. Moreover, you have not shown that you are formed exclusively for an exempt purpose under section 501(c)(3) of the Code. The facts show your intent to obtain grants and use those funds to supplement the income and operations of F, a for profit restaurant. For these reasons, you do not satisfy the operational requirements of the Code.

You do not meet the provisions of Section 1.501(c)(3)-1(c)(2) of the Regulations as your funding will be used to further the personal interests of B and her family. As you have stated, funding that is secured will be used to pay for food prepared by F, either through a meal voucher program or for food purchased that will be distributed in other manners. Any earnings derived by F through this activity will directly inure to insiders. A business plan submitted to obtain grant funding included a segment on marketing wherein it is described how through events such as serving meals at police fund raisers or providing food to local community organizations the public would be further exposed to F. You have described these as activities you will conduct. By using your operations to increase marketing, thereby increasing exposure and business for F, you are providing a direct benefit to your insiders; the owners of F. You also do not meet the provisions of Section 1.501(c)(3)-1(d)(1)(ii). As you are set up to benefit one family, and inurement is present, you are also serving substantially private interests.

As seen in the Better Business Bureau ruling, the presence of any non exempt purpose, if substantial in nature, will preclude exemption. In using public funding to subsidize the operations of a for profit business you are serving non exempt purposes. You have also indicated H determined your yearly operating budgets, including the division of revenue and expenses and the delineation of grant funding split between you and F. H has controlled every aspect of the application process. Only one grant has been applied for and that was for F. The only application that was submitted was done at least two months prior to your creation with budgets for F. This demonstrates that you have not been formed

independently for 501(c)(3) purposes but merely as part of a process to assist in obtaining grants for F.

Similar to the organization in KJs Fund Raisers, the same individual, B, will have control over you and will also be simultaneously managing F. You are structured to allow the flow of funds from you to F. The decision to use F as an integral part of your operations coupled with your limited board demonstrates a lack of public oversight and/or control. Any public benefit here is limited and incidental to private interests being served.

Similar to the organization in Church by Mail, dual control exists between you and F and enables those owners of F, your founders, to benefit from this relationship. Through your activities F will directly benefit through increased exposure as well as subsidized food sales through either grant funds or donations. Further, the owner of F, B, as well as her family, will directly benefit through any increased food sales. Like the organization in International Postgraduate Medical Foundation, F benefits substantially from your operations in the form of the receipt of public funding to expand and supplement its business purposes. Because you are formed to further private interests through your operations you do not qualify for exemption under Section 501(c)(3).

You are similar to the organization described in P.L.L. Scholarship Fund. The information submitted shows you and F are essentially one in the same. As the history of your formation shows, without F you never would have been created. Your activities will be directly linked to the operations of F. F will create the meals you intend on giving away. Also, as indicated, any funding you are to receive is tied directly to your approval. Funds cannot be independently obtained either for you or F without your existence. You will be managed and run by the same individuals, (B, C, D) You will use the same facility. Your functions and management are interrelated so as to be functionally inseparable. For this reason you are established to benefit private interests, the owners of F, and are not operated exclusively for exempt purposes.

As an applicant for exempt status, you must provide sufficient information to allow for an informed decision. (National Association of American Churches). You must respond to questions completely and candidly. When asked about food vouchers given to individuals to be redeemed at company F you stated that "At no point in our responses did we state or propose the idea of redeemable food vouchers". In fact your narrative description and financial statement shows "The meals would be offered through a number of sources. They would be donated to local individuals through the use of vouchers", "Families would be able to exchange their meal vouchers on any business day at F to receive their free meals", and "Families would then be able to apply for free meal vouchers directly at the event". You stated that to help accomplish these goals you will need to hire local residents to help you in food production and distribution. In this way through the simple actions of this charity you would better your town and its residents through employment and charity. However, when asked specifically who will be hiring employees you stated F after receiving a grant from H would be hiring the employees. These two contradictions are

clear examples of the inability to distinguish between you and F. Without clear and candid information exemption cannot be given.

Applicant's Position:

You have indicated that you and F are two separate entities and any funding received for F will be used by and for F. Any funding you receive will be used for charitable purposes to support small businesses.

Response to Applicant Position:

Whether funding is received jointly or separately your operations are established to provide support and growth to F. No expense projections or activities have been described that include details on helping small businesses. All information given points towards a purpose of increasing the business of F, updating F's facility and equipment and doing so through funds obtained with the assistance of H through you. Through your contact with H you have been led to formation not for charitable purposes but to obtain grants that will be used for non-charitable purposes. Without the existence and operation of F you would not have been formed and your activities will be reliant upon F's continued existence. You have indistinguishable comingled operations with a for profit entity owned by your insiders and for this reason do not qualify.

Conclusion:

You were formed to secure funding for F, a for profit entity owned by B. Both B and F will benefit directly from your operations as well as H. B and F through increased food sales and distribution, H through direct fees and portions of grants received. You have not sufficiently detailed your food distribution and small business assistance programs and are inherently inseparable from the activities of F. You fail the operational test as you cannot establish operations are charitable and will not benefit insiders, directly or indirectly, in a more than substantial manner. Additionally, you fail the organizational test as the language in your organizing document is insufficient for 501(c)(3) qualification. Accordingly, you do not qualify for exemption under Section 501(c)(3).

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892; *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". These items include:

1. The organization's name, address, and employer identification number;
2. A statement that the organization wants to appeal the determination;
3. The date and symbols on the determination letter;
4. A statement of facts supporting the organization's position in any contested factual issue;
5. A statement outlining the law or other authority the organization is relying on; and
6. A statement as to whether a hearing is desired.

The statement of facts (item 4) must be declared true under penalties of perjury. This may be done by adding to the appeal the following signed declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations

Enclosure, Publication 892